U.S. SENATE BANKING COMMITTEE

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Opening Statement of Chairman Dodd
"The State of the Economy and Capital Markets"

Remarks as Prepared:

I call the Committee to order.

Today the Committee meets to discuss the state of our nation's economy and capital markets. I am pleased to welcome before the Committee three of country's leading economic figures, Treasury Secretary Hank Paulson, Federal Reserve Chairman Ben Bernanke, and Securities and Exchange Commission Chairman Chris Cox. Gentlemen, thank you for joining us today. I want to note that the last time the heads of all three of these agencies appeared jointly before the Committee to discuss the state of our nation's economy was in the immediate aftermath of the tragic attacks of September 11, 2001. While the challenges the nation's economy faces today are very different from those that were faced then, today's economic challenges are, unfortunately, no less serious.

The current economic situation is more than merely a "slowdown" or a "downturn". It's more, even, than a mere recession or near-recession. Instead, it is a crisis of confidence among consumers and investors. Consumers are fearful of borrowing and spending. Investors are fearful of lending. Financial transactions which generate new businesses and new jobs are shrinking in number and size.

The incoming economic data shows how serious the problem is. The nation's economy slowed to a near standstill in the fourth quarter, with overall GDP growing by less than one percent and private-sector GDP growing by only one-tenth of one percent. The country had a net loss of jobs in January, the first time that we have lost jobs in over 4 years. Incoming data on retail sales have been very weak and most projections for economic growth this year have been revised down sharply. Credit card delinquencies are on the rise – as consumers find themselves increasingly unable to tap the equity in their homes to help pay down credit card and other bills. Lastly, inflation increased by 4.1 percent last year – the largest increase in 17 years, driven mainly by the rising costs of energy, food, and health care. Industrial production is falling and we have been hemorrhaging jobs in the construction and manufacturing sector. This decline has been reflected in falling stock prices and increased volatility in the securities markets. Our economy is clearly in trouble. The most important thing we can do right now is act to restore consumer and investor confidence.

To that end, I commend Fed Chairman Bernanke for taking an active role in addressing the weakness in our economy through injecting much-needed liquidity and cutting interest rates. I also am pleased that the Administration and the Congress were able to reach agreement on a stimulus package that provides some support for working families who are bearing the brunt of these difficult times. However, more needs to be done to address the root cause of our economic problems. And, I say respectfully, that includes by the three agencies led by our witnesses today.

The catalyst of the current economic crisis is the housing crisis. Housing starts are at their lowest levels in a quarter-century. The inventory of existing homes for sale stands at nearly 4 million units, almost double the number in January, 2005. This is equal to about 10 months of supply. While many of us have experienced home price drops in our own states and regions, overall, 2007 was the first year since data has been kept that the United States had an annual decline in *nationwide* housing prices. A recent Moody's report forecasts that home values will drop in 2008 by 10% to 15% and others are predicting similar declines in 2009 as well. This would be the first time since the Great Depression that national home prices have dropped in consecutive years.

If the catalyst of the current economic crisis is the housing crisis, then the catalyst of the housing crisis is the foreclosure crisis. This foreclosure crisis was triggered by what Secretary Paulson himself has called "bad lending practices". These are lending practices that no sensible banker would ever engage in. Reckless, careless, and sometimes unscrupulous actors in the mortgage lending industry essentially allowed loans to be made that they knew hard-working, law-abiding borrowers would not be able to re-pay. And they engaged in practices that the Federal Reserve, under its prior leadership, and the Bush Administration did absolutely nothing to effectively stop. The problems were compounded by inaccurate and misleading corporate disclosures and asset valuations, inflated credit ratings, and poor risk management, so investors could not act as a check on the problems.

As a result of failures throughout the chain of mortgage finance, from origination to securitization, foreclosures are at record levels. There are 1.5 million homes that are seriously delinquent or in foreclosure right now. And we haven't seen the worst of it. Economist Mark Zandi estimates that 3 million loans will default between 2007 and mid-2009, and 2 million of those homes will end up in foreclosure.

The crisis affects more than the families who lose their homes. Property values for each home located within a one-eighth of a mile of a foreclosed home will drop by an average of $5,000. This will affect 44 to 50 million homes. The foreclosure crisis will result in an increased demand for social services, for police and fire, and for other services to ameliorate the impact of increases in foreclosures and abandoned property. Yet, state and local governments will have fewer resources with which to meet these demands, as property values and tax collections drop. Localities will lose $4.5 billion in property taxes and other revenue due to this wave of foreclosures.

Any serious effort to address our economic woes must include an effort to take on the foreclosure crisis. That is a critical step toward restoring the confidence of consumers and investors in our economy.

We on this Committee have already taken several steps to address these problems. We worked to reform to the FHA program and passed FHA modernization legislation through the Senate by a vote of 93 to 1. Now we need to make sure that this becomes law. We appropriated close to $200 million to facilitate foreclosure prevention efforts by borrowers and lenders. In addition, the recently enacted stimulus package includes a temporary increase in the conforming loan limits for the GSEs to try to address the problems that have spread through the credit market into the jumbo mortgage market. While this is helpful we still need to implement broad based GSE reform and I am committed to do that.

And I have spoken about my belief in the need for additional steps to mitigate the foreclosure crisis in a reasonable manner. These steps include targeting Community Development Block Grants to communities struggling to counter the impact of foreclosed and abandoned properties. And they include establishing a temporary homeownership loan initiative – either using existing platforms or a new entity – that can facilitate mortgage refinancings.

But it's not just the Congress that needs to do more. The Administration – including the agencies represented here this morning – needs to do more, as well. Much more.

Almost a year ago, I convened – with Sen. Shelby – a summit of leading lenders and servicers. The attendees at that summit agreed to a set of principles that requires them create a permanent, affordable solution, wherever possible, for at-risk borrowers. Unfortunately, the Administration has been working at cross-purposes with us. Instead of helping us hold lenders and servicers to the commitments they made at the Summit, they have in essence sanctioned backsliding from the kind of aggressive, broad-based effort that is more urgently required by the day. The latest Administration effort – dubbed "Lifeline" – is a lifeline more to lenders than to borrowers. The Treasury Department, HUD, and others in the Administration must do more.

Similarly, the Federal Reserve, as the lead financial regulator, needs to break with its past and become more vigilant about policing indefensible lending practices. I commended Chairman Bernanke last year when the Fed finally accepted its duty under the Home Ownership and Equity Protection Act to protect consumers from unfair and deceptive mortgage lending practices. But the Fed's recent proposed rule does not go far enough, in my view, to carry out that duty. I want to work with the Chairman and his colleagues, and urge them to consider stronger measures which will not only protect consumers, but also restore investor confidence in our mortgage markets so we can begin to see liquidity return to all facets of the mortgage market.

As for the SEC, I commend Chairman Cox for his oversight of the credit rating agencies and for enforcement efforts related to subprime-related cases. But here again, greater vigilance is urgently required. The SEC needs to help restore investor confidence in the markets by more vigorous enforcement, by more comprehensive regulation of credit rating agencies, and increased accountability and transparency of publicly traded companies that are engaged in our mortgage finance system.

Despite these unprecedented challenges, I remain confident in the future of the American economy. We may need to change some our policies, regulations and priorities, but the ingenuity, productivity and capability of the American worker and entrepreneur ought to never be underestimated. I look forward to working with Ranking Member Shelby and other on the Committee to work to address these issues and do what we can to put our nation's economy back on the right track.

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